



**Andrew Junkin, CFA, CAIA**  
**Managing Director & Principal**

April 27, 2011

Dr. George Diehr  
Chair of the Investment Committee  
California Public Employees' Retirement System  
400 Q Street  
Sacramento, CA 95814

Re: Long Term Care Program Asset Allocation

Dear Dr. Diehr:

You requested Wilshire's opinion with respect to Staff's review of asset allocation options for the Long Term Care Program.

### **Overview and Recommendation**

**Wilshire recommends that the Investment Committee approve Portfolio P4 for the Long Term Care Program. Portfolio P4 is only a modest change from the current portfolio, with lower expected volatility, greater inflation protection, and only a modest reduction in expected return.**

### **Discussion**

Over the next year, Staff plans on conducting a thorough review of the Program and will present plan recommendations and a restructuring plan for the Program to the Health Benefits Committee. As such, Staff asks that this asset allocation be an interim allocation for the next year. However, the program will continue to operate, so the asset allocation cannot have a one year time horizon, which would result in a very conservative portfolio (likely all cash). Until the Program review and restructuring are complete, Wilshire recommends only marginal changes. Currently the plan is relatively well funded, is cash flow positive (contributions exceed distributions and are forecasted to for several years), and is invested with a moderate level of expected volatility.

Wilshire recommends Portfolio P4 as it increases the inflation protection of the portfolio (TIPS increase 8%, commodities increase 3%), maintains a similar level of equity exposure (Global Equity + REITs decreases by 1%), has a lower level of expected volatility (8.63% versus 9.62%), and only marginally reduces expected returns (6.25% versus 6.38%). Given that the likelihood of premium increases rises as the expected return falls, Portfolio P4 seems to balance the opportunity for higher returns with



downside protection. More conservative portfolios lead to near-certain premium increases.

Staff has also included Portfolios P2 and P3 as potential candidate portfolios, both of which are more conservative than P4. While both P2 and P3 would be appropriate if the Investment Committee desired to de-risk the Program more substantially, Wilshire believes that a gradual shift is more appropriate until the outcome of the restructuring plan is known. If markets fall significantly during the review of the Program, it is likely that P2 and P3 will outperform P4 by losing less, given the more conservative positioning of each.

As we have noted in prior asset allocation items, sound judgment must be applied as the basis for the allocation study are estimated returns, risks and correlations, which are imprecise.

### **Conclusion**

Wilshire recommends the Investment Committee adopt Portfolio P4 as the interim asset allocation for the Long Term Care Program. Once the review and restructuring recommendation is presented to the Health Benefits Committee, the asset allocation should be reconsidered.

Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,

A handwritten signature in black ink, appearing to read 'Ann Jain'.